MidAmerican Ill. C. C. 13th Revised Sheet, Rate 30.40
July 11, 2003

Determination of Avoided Costs for Illinois Rate 57
Wholesale Sales Should not be Included

Background

MidAmerican has objected to including wholesale sales in determining avoided costs for Rate 57 since the 2000 filing to the ICC. For the reasons stated below, MidAmerican believes it is improper and inaccurate to include wholesale sales in avoided cost calculations. It is inconsistent with PURPA's/ICC's definition of avoided costs, does not hold the buyer harmless, and creates volatility in rates to the detriment of the buyer and the PURPA Qualified Facility ("QF").

PURPA/ICC Definition

PURPA/ICC defines avoided cost as:

> "'Avoided costs' means the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." Ref. 18 CFR PART 292.101 Definitions; 83 Ill. Admin. Code 430.30.

Wholesale sales should not be included in avoided cost calculations

1. The PURPA and ICC definition of avoided cost shown above does NOT specify inclusion of wholesale sales. Congress and FERC could have included wholesale sales in the definition if that had been their intent. Since there is no specific reference to include such sales in the definition, it would not be consistent with the definition for the ICC to include wholesale sales in the avoided cost calculation.

2. By using the words "such utility would generate itself or purchase from another source", PURPA and the ICC did not envision wholesale sales to be a part of avoided costs. Public utilities, as defined by the Federal Power Act and the Illinois Public Utilities Act, generate or purchase energy to meet the obligation to serve retail customers. Wholesale sales are only conducted after retail demand is met with the least-cost resources and only if higher cost resources can be sold economically in the wholesale market. The price at which these sales are conducted does not represent the cost to serve retail demand. Therefore, avoided costs should be based on costs that are avoided to serve retail load consistent with PURPA's and ICC's definition of avoided costs. Including wholesale sales violates this principle.

3. Clearly the intent of avoided cost is to hold the utility and its retail customers harmless in the transaction. The language in PURPA and ICC definition "but for the purchase from the qualifying facility or qualifying facilities" defines this principle. In other words, only those costs that the utility and its retail customers avoid by purchasing from the QF should be included in the calculation of the rate paid to the QF. The utility and its retail customers should neither be advantaged nor disadvantaged by the transaction. Wholesale sales are not directly related to the cost to serve retail load and are, in part, based on assumptions of wholesale market prices that can be significantly different than actual experienced market prices. Thus, inclusion of such sales in the avoided cost calculation fails to hold the utility and its retail customers harmless and violates a major principle of PURPA.

4. Avoided cost calculations should provide for stable, consistent rates which are to the benefit of the utility and QF. The utility requires a rate that reflects the true cost to be avoided ("but for the purchase from the qualifying facility or qualifying facilities ") which is not reflective of volatile wholesale prices. Wholesale prices, as we know, in the last few years have experienced high volatility. MidAmerican's cost to serve retail generation (i.e. cost to be avoided) is based on coal, nuclear, and to a very small extent natural gas fired generation and purchases. Therefore, MidAmerican's cost of retail generation does not vary based on the wholesale market sales. It follows then that wholesale sales should not be included in the "but for" language in the avoided cost definition for MidAmerican.

   The QF is advantaged by consistency in pricing when making a decision to build generation and sell the output to the buyer. If the rate is based on KNOWN and MEASURABLE variables, the QF can make informed financial decisions with some assurance that the unit's economics will not significantly vary from year to year. Financial institutions depended on by the QF for loans will also be wary of a rate that can significantly vary (up or down) from year to year. The forecast of electric wholesale prices, and subsequently wholesale sales, introduces a marked increase in uncertainty in the calculation of avoided costs. This could have the impact of discouraging further development of PURPA-qualified facilities.

5. At the time PURPA was developed, wholesale market prices, regulated by the FERC, were either cost-based or a split of savings between the utilities involved in the wholesale transaction. As such these sales were based on one or more utility specific costs. In today's wholesale market, prices are market-based and do not represent the cost of any particular utility's generation or actual cost to serve retail customers. Therefore, an avoided cost calculation that is based, in part, on wholesale sales priced at market is contrary to the concept of avoided costs as defined by PURPA and ICC.

6. Although a clear case can be made to exclude all wholesale sales from avoided cost calculations, MidAmerican did include CONTRACTED sales with

contracted purchases in its calculations. These transactions, which usually are based on a specific contract that obligates the buyer and seller to transact business under defined terms and conditions including rates, are KNOWN and MEASURABLE and can be accurately modeled in avoided cost calculations. For example, for calendar year 2003 calculations, MidAmerican included 408 MW and 3,220,227 MWh of purchases and 192 MW (summer; 184 MW for the winter season) and 911,975 MWh of sales (according to rates defined in the separate agreements) in the avoided cost calculations made for Rate 57.

MidAmerican continues to believe that wholesale economy sales should be excluded from the avoided cost calculations. Wholesale economy sales consist of spot market wholesale sales that occur over a relatively short time period, usually hourly, weekly, or monthly. The level and price of wholesale economy sales are UNKNOWN and UNPREDICTABLE and as such cannot be precisely modeled in avoided cost calculations. Wholesale economy sales are NOT guaranteed to take place by their very nature. These are unpredictable sales that depend on volatile wholesale market prices, availability and cost of energy resources of the buyer and seller, transmission path availability and cost, and weather at the moment in time that the buyer and seller desire to conduct business. The wholesale price of spot market energy clearly does not represent MidAmerican's "incremental cost … such utility would generate itself or purchase from another source".